



# Is Negative Interest Rate Effective?

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## Abstract

On February 16, 2016, a year and a half after the European Central Bank implemented an unprecedented monetary policy of setting a negative interest rate to stimulate its flagging economy, Japan followed this bold move by setting its own interest rate below zero. By charging negative interest rate on excess funds that commercial banks hold at Bank of Japan, the central bank is hoping that banks will be encouraged to lend instead of hoarding cash, and businesses and households to spend and invest.

This research is a narrative approach to examine the pros and cons of negative interest rate policy in Europe and Japan. Additionally, to evaluate whether this policy is effective or not.



## Main Arguments

Conventional wisdom dictates that interest rates shouldn't be negative, known in economics as "zero lower bound."

However, some economies are contracting and the central banks in these countries are running out of options to stimulate economic growth as everything else has been tried already.

In the Eurozone, Denmark, Sweden, Switzerland and Japan, commercial banks are charged negative interest rates on excess funds held on deposit at these central banks.

The purpose of negative interest rate in the Eurozone is to stimulate its economy and increase inflation. In Danish and Swiss central banks wanted to prevent their currencies from rising too much too quickly.

While the stock markets in these countries have responded well, savers are hurt by this since there is no incentive to save in these countries.

## Conclusion

It is still too early to determine definitively whether negative interest rates will actually spur economic growth in the Eurozone and other countries that implemented this policy.

With countries with flagging economies running out of options to stimulate growth, more countries will be experimenting with radical and desperate measures to bring their economies out of the doldrums.

Although the immediate effects of negative interest rate have been more undesirable than fulfilling its intended effects, some time need to pass before these effects can be properly assessed.

## References

Forelle, Charles. "Everything you need to know about negative interest rates." *The Wall Street Journal* 28 Feb. 2016.

Walker, Andrew. "Why use negative interest rates?" *BBC News* 16 Feb. 2016.

Zervos, Sara. "What negative interest rates means for savers and investors." *Forbes* 22 Feb. 2016.



## Key Questions

1. How does negative interest rate work?
2. Why did the European Central Bank and Bank of Japan implemented negative interest rates on their economies?
3. Is the policy effective in these economies?
4. What are the intended and unintended effects of negative interest rates on these economies?

World Government Bond Yields, %, Feb 19 2016

Tenor (years)	DENMARK	FRANCE	SWEDEN	AUSTRIA	FINLAND	NETHERLAND	GERMANY	SWITZERLAND	JAPAN
1	--	-0.40	--	-0.43	-0.48	--	-0.54	-0.97	-0.18
2	-0.31	-0.42	-0.61	-0.46	-0.49	-0.50	-0.53	-1.05	-0.21
3	--	-0.35	--	-0.43	-0.42	-0.46	-0.48	-1.02	-0.21
4	--	-0.27	-0.43	-0.32	-0.34	-0.38	-0.42	-0.91	-0.19
5	-0.04	-0.16	-0.12	-0.26	-0.20	-0.31	-0.33	-0.80	-0.17
6	--	-0.06	--	-0.14	-0.15	-0.21	-0.28	-0.70	-0.16
7	--	0.07	0.13	0.03	0.02	-0.08	-0.18	-0.63	-0.15
8	0.22	0.18	0.30	0.17	0.12	0.06	-0.07	-0.50	-0.11
9	--	0.38	--	0.33	0.28	0.17	0.08	-0.40	-0.06
10	0.52	0.56	0.50	0.50	0.49	0.34	0.20	-0.33	0.01

Source: Bloomberg